No. 13,805

In the United States Court of Appeals for the Ninth Circuit

COMMISSIONER OF INTERNAL REVENUE, PETITIONER,

v.

THOMAS H. BRODHEAD AND ELIZABETH S. BRODHEAD, RESPONDENTS.

ON PETITION FOR REVIEW OF THE DECISIONS OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE PETITIONER

H. BRIAN HOLLAND,
Assistant Attorney General.

ELLIS N. SLACK,
LEE A. JACKSON,
JOSEPH F. GOETTEN,
Special Assistants to the Attorney General.

FILED

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OPINION BELOW

The opinion of the Tax Court (R. 140-161) is reported at 18 T. C. 726.

JURISDICTION

The petition for review in these cases involves deficiencies aggregating $169,553.49 in the federal income taxes of the taxpayer, Thomas H. Brodhead, and his wife, Elizabeth S. Brodhead, for the years 1943, 1944, 1945 and 1948. (R. 5, 18, 163-169.)

On February 7, 1950,[1] the Commissioner of Internal Revenue mailed to the taxpayer and his wife notices of deficiencies in their income taxes for the years in question. (R. 11, 29.) Within 150 days thereafter, on July 3, 1950 (R. 1, 4), the taxpayer and his wife, pursuant to Section 272 of the Internal Revenue Code, filed petitions with the Tax Court for redetermination of such deficiencies. The proceedings were consolidated for hearing in the court below. (R. 2, 4.) On October 31, 1952, decisions of the Tax Court were entered redetermining the deficiencies. (R. 162, 163.) On January 19, 1953, the Commissioner filed his petition for review invoking the jurisdiction of this Court under Section 1141(a) of the Internal Revenue Code, as amended by Section 36 of the Act of June 25, 1948. (R. 163-167.)

QUESTIONS PRESENTED

1. Whether in transferring property in trust for the benefit of his minor children then living and those yet to be born the taxpayer retained sufficient control over that property to be treated for tax purposes as the recipient of income therefrom when (a) the trusts were required to use that property to acquire a special or limited partner's interest in a family partnership in which the taxpayer was the controlling general partner, and (b) the trusts were not free to terminate or transfer their interest once the partnership was created.

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[1] There were added to the gross income of the taxpayer and his wife for each of the years in question amounts in excess of 25 per cent of the amounts of gross income stated in their joint returns. (R. 13, 33, 36, 38.) See Section 275(c) of the Internal Revenue Code. On or about January 18, 1949, a consent was executed extending to June 30, 1950, the period within which an income tax might be assessed or a deficiency notice mailed to the taxpayer for the year 1943. (R. 151-152.)

2. Whether trusts, which the taxpayer claims should be recognized for tax purposes as special or limited partners solely on the basis of their contribution of gift capital to the partnership, were the true owner-contributors of such capital when they were not free to withhold such capital from the partnership, to transfer the partnership interest allegedly required for the capital, or to withdraw from the partnership either the capital or income attributable to it.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and Regulations are set forth in the Appendix, *infra*.

STATEMENT

The facts found by the Tax Court, which are based in part upon a stipulation (R. 44-137), may be summarized as follows:

The taxpayer, Thomas H. Brodhead, and his wife, Elizabeth S. Brodhead, at all times material to these proceedings were residents of the Territory of Hawaii. They have three children born December 29, 1939, November 19, 1942, and May 1, 1945. (R. 141.)

In and prior to 1942 the taxpayer was engaged as an individual in operating a wholesale merchandise business in Honolulu. The merchandise handled consisted of a great variety of articles which were sold to post exchanges and ships' service stores and included drug items, razor blades, dungarees, shoes, underwear, work shirts, shower clogs, pocket knives, candy, gum and miscellaneous items. (R. 141.)

The taxpayer came from a family of short-lived people on his father's side and he was quite concerned about the length of his own life. Conditions in Hawaii in 1942

were not conducive to a feeling of long life. He was determined to make some provision for his children so that they would have a better education than he had. In September 1942 the taxpayer and his wife had one child, and were expecting the birth of another. The taxpayer's business grew rapidly after the start of World War II, and he wanted some means of having it carried on for the benefit of his children in the event of his death. Also, because of the size to which the business had grown in 1942 he felt that he needed someone to help him with it. (R. 141-142.)

Mortimer J. Glueck had been a personal and business acquaintance of the taxpayer for a number of years, had kept his books on a part time basis, and had advised him generally. Glueck had a commission business, and in 1942 he was getting too busy with it to be able to assist the taxpayer and advised him to get other assistance. Glueck and the taxpayer had many discussions as to what provision the latter should make for his children. (R. 142.)

Bishop Trust Company, in and prior to 1942 conducted a trust company business in the Territory of Hawaii. It is operated as a professional fiduciary, with side issues such as insurance, real estate sales, and brokerage. Its main business is the administration of estates, trusts, guardianships and agency accounts. The normal trust or estate handled by the trust company consists of securities or interests in real estate. However, it has at times administered proprietorships and the controlling shares of incorporated businesses. In the administration of such properties it has operated various businesses including a structural steel mill, a department

store, dairies, ranches, a bottling company, and an automobile agency. (R. 142.)

In 1942 Glueck and the taxpayer sought the advice of counsel, and it was agreed that a trust should be created for the benefit of the children of the taxpayer and his wife and that the trust should become a partner with the taxpayer in his business. The taxpayer asked Glueck to be one of the trustees so that with his knowledge of the business he could carry it on in the event of the taxpayer's death. The taxpayer also wanted Bishop Trust Company as a trustee for the general assistance and advice that it could give. (R. 143.)

On September 30, 1942, the taxpayer created the Thomas H. Brodhead Trust, naming Mortimer J. Glueck and Bishop Trust Company as trustees. Corpus of the trust was stated to be $40,000. It consisted of a one-half interest in the taxpayer's business which at that time had a net worth of $80,000. Under the trust agreement, the $40,000 corpus was to be contributed to the capital of a special partnership to be organized concurrently for a 50 per cent interest therein. (R. 143.)

The trustees were required to accumulate all trust income during the continuance of the trust, but they had discretion to pay out net income for the maintenance, support, and education of the children of the settlor, or if income was insufficient they could use corpus. All income not used for such purposes was to be accumulated and added to corpus. The trustees were authorized to pay to any child of the settlor any time after attaining age 21, as they deemed proper, such portion of corpus and accumulated income as constituted one share, such share to be determined by considering the trust estate

to be divided into as many equal shares as there should be children then surviving or lineal descendants of any deceased child. (R. 143-144.)

The trust was to continue until 20 years after the death of the settlor. The trust property and accumulated income were then to be distributed to the surviving children of the settlor (other than those to whom the distribution of a share may have previously been made) and the issue of any deceased children. If there were no children or issue then surviving, distribution was to be made to those persons, other than the settlor, who would be the heirs-at-law of the last survivor of the children of the settlor. (R. 144.)

The trustees could terminate the trust at any time after the termination of the special partnership, in which event distribution was to be made to the settlor's children and issue of any deceased children. (R. 144.)

The trustees were given broad powers to invest and reinvest and manage the trust property, but during the life of the settlor they were required to obtain his consent to all investments. After the settlor's death the trustees were to be restricted in making investments to those which trustees are permitted by law to make. However, they could in any event make advances or loans to the special partnership without liability for any loss resulting therefrom. (R. 144.)

The settlor reserved the right to transfer additional property to the trust. The trustees were required to furnish annual statements of account to the benficiaries. The corporate trustee was given the custody of all money or securities in the trust. (R. 144-145.)

The trust was declared to be irrevocable by the settlor. It was provided that in no event should any of the trust

property or income be paid to or inure to the benefit of the settlor. (R. 145.)

Any alteration, amendment, cancellation, or revocation of any provisions of the trust required the written consent of the trustees and all of the beneficiaries. (R. 145.)

A special partnership was formed by a document dated as of September 30, 1942. The taxpayer was referred to therein and signed the agreement as "General Partner." The trustees of the above described trust are referred to and signed as "Special Partner." The partnership adopted the name of T. H. Brodhead Company. Its purpose was to acquire the assets and carry on the business theretofore conducted by the taxpayer. Other purposes are stated including the carrying on of any business that may lawfully be carried on by a partnership. (R. 145.)

The initial capital of the partnership was $80,000 which was the book value of the net assets that it acquired. It was agreed that $40,000 was the capital contribution of each of the partners and that each had a 50 per cent interest. (R. 145.)

The general partner who was actively engaged in the business was to receive compensation for his services which was to be charged as an expense in computing partnership profits. The remaining profit, or loss, was to be divided in proportion to the capital contributions. Profits attributable to each partner's interest could be withdrawn from time to time as the partners deemed advisable. (R. 145-146.)

The trustees had all the powers, rights, and duties of a special partner as prescribed by designated sections of the Special Partnership Law of the Territory of

Hawaii, and were not liable for partnership debts beyond the extent prescribed by law. (R. 146.)

Only the general partner had authority to transact the business of the partnership, or incur obligations. He was to establish the policy of the partnership. The special partner could at all times investigate the partnership affairs and advise the general partner as to its management. (R. 146.)

The general partner could not assign or mortgage any part of his interest. The special partner could assign its interest with the consent of the general partner. (R. 146.)

Proper partnership books and records were to be kept and each partner was to have full access to them. The books were to be audited at least once a year, and a copy of the auditor's report was to be delivered to each partner. Annual accounts were to be taken, showing the capital of the partnership and the interest of each partner therein and copies were to be furnished to each partner. (R. 146.)

The partnership could be terminated by the general partner on two months' written notice. On termination, debts were to be paid, and any balance remaining was to be applied first to advance accounts of the partners, then to capital, then between the partners in the manner provided for division of profits. If the balance after payment of debts was insufficient to pay in full the advance accounts of all partners, the special partner was to be paid first. (R. 146-147.)

In the event of the death of the general partner, his representative had the option of succeeding to or carrying on his interest in the business as a general partner. (R. 147.)

The partnership was to continue for a ten-year period and thereafter from year to year until terminated by either partner giving three months' notice. (R. 147.)

By bill of sale dated as of the close of business on September 30, 1942, the taxpayer conveyed to the special partnership the rights, property, assets, and privileges owned by him and used in his merchandising business. The partnership agreed in the bill of sale to assume the liabilities disclosed by the balance sheet attached thereto. The balance sheet listed assets in the amount of $178,598.73, current liabilities in the amount of $98,598.73, and capital in the amount of $80,000. Among the assets listed were cash, $21,532.34; accounts receivable, $64,667,35; and merchandise inventory, $27,310.44. (R. 147.)

The required documents concerning the organization of the special partnership were duly filed and publication was made in a Honolulu paper. (R. 147.)

Early in 1943, the taxpayer was advised by his attorney that under a recent court decision he might be subject to federal income tax on all of the income of the Thomas H. Brodhead trust without being able to get any of the trust income to use to pay the tax. In that situation, it was possible that he might have been unable to pay the tax. He was advised by counsel that a new trust could be created, omitting the features that might make the income of the first trust taxable to him, to acquire the interest of the first trust in the partnership. (R. 147-148.)

Following discussions among the taxpayer and his wife, the trustees of the Thomas H. Brodhead trust, and counsel, the taxpayer's wife Elizabeth S. Brodhead on February 28, 1943, created the Elizabeth S. Brodhead trust. The trustees of that trust were the same as

those of Thomas H. Brodhead trust. At that time, the taxpayer gave his wife $10,000 which she paid in to the trust created by her. Both the taxpayer and his wife filed federal gift tax returns in which they reported the gifts of $10,000 made by them. (R. 148.)

The provisions of the Elizabeth S. Brodhead trust were substantially the same as those of the Thomas H. Brodhead trust. The principal differences were that the wife's trust did not give discretion to the trustees to distribute income for maintenance, support, or education of the beneficiaries during minority, and it was to terminate when the youngest child attained the age of 33 years. (R. 148.)

On February 28, 1943, the Elizabeth S. Brodhead trust purchased from the Thomas H. Brodhead trust its 50 per cent interest in the special partnership. That interest was duly assigned to the Elizabeth S. Brodhead trust by an instrument dated February 28, 1943, in which the taxpayer, as general partner gave his consent to the assignment. The Elizabeth S. Brodhead trust paid the Thomas H. Brodhead trust the sum of $10,000, and gave its note for the unpaid balance of the purchase price of the 50 per cent interest in the amount of $30,000 with interest at five per cent. Interest was paid periodically, and the principal of the note was paid off by payments made in 1945 and 1949. The legally required certificate of change of the special partnership and affidavits were duly filed, and notice was duly published. (R. 148-149.)

An independent firm of auditors was employed by the partnership to make audits of the partnership business and to prepare annual statements. (R. 149.)

The taxpayer received compensation for his services to the partnership for the periods and in the amounts as follows (R. 149):

Period or Year	*Amount*
October 1, 1942, to February 28, 1943..	$ 6,250.00
Fiscal year ended February 28, 1944..	15,000.00
Fiscal year ended February 28, 1945..	18,000.00
Fiscal year ended February 28, 1946..	18,000.00
Fiscal year ended February 28, 1947..	18,000.00

As of the close of business on February 28, 1947, the name of the special partnership was changed from T. H. Brodhead Company to Ace Distributors. The instrument changing the name was executed by the taxpayer as general partner and by Mortimer J. Glueck and Bishop Trust Company, trustees under the Elizabeth S. Brodhead trust, as special partner. The necessary documents to effect the change were duly filed and publication was duly made. (R. 149-150.)

As of the close of business on February 28, 1947, the partnership, under its new name of Ace Distributors, assigned T. H. Brodhead Company, a Hawaiian corporation, certain rights, property and assets used in its business, subject to balance sheet liabilities, which properties had a net book value of $80,000. In payment therefor the corporation issued 4,000 shares of its stock to the general partner and an equal number to the special partner. The necessary documents in connection with the organization of the corporation and the issuance of its stock were duly filed. (R. 150.)

During the period of operations of the special partnership, the general partner discussed the problems of the business frequently with the trustees of the two trusts. Whenever a financial report on the business

was issued he furnished copies to the trustees. The general partner conferred with the corporate trustee as to investment of the funds of the first trust. In one instance it accepted his suggestion as to an investment and in another instance it refused to do so. He discussed with the trustees possible means of financing an expansion of the partnership business which in the war years was increasing in volume. (R. 150.)

The partnership T. H. Brodhead Company filed partnership returns on an accrual and fiscal year basis ending on the 28th of February. Its first return on that basis was filed for the fiscal year ended February 28, 1943. Returns were filed on that basis for each of the subsequent fiscal years 1944 through 1949. (R. 150-151.)

The Thomas H. Brodhead trust and the Elizabeth S. Brodhead trust filed federal fiduciary returns each year and duly paid the tax shown to be due thereon. None of the funds of the trusts has ever been paid out to the beneficiaries thereof. Out of the income of the trusts there have been paid the expenses of each, such as trustee fees, tax service fees, and the federal and territorial income taxes. (R. 151.)

On September 30, 1950, the assets of the Thomas H. Brodhead trust amounted to a total of $86,918.97, which consisted of cash in the amount of $2,109.48 and investments in stocks, bonds, and savings and loan certificates with a cost of $84,809.49. (R. 151.)

On February 28, 1951, the assets of the Elizabeth S. Brodhead trust amounted to a total of $85,673.03, which was made up of cash, $3,858.90; partnership equity in Ace Distributors, $2,904.85; accounts receivable received in partial liquidation of Ace Distributors, $17,-

000; 4,000 shares of stock in T. H. Brodhead Company, $40,000; other stocks having a cost of $13,409.28; savings and loan certificates with a cost of $8,500. (R. 151.)

The two trusts were bona fide trusts for the benefit of the children of the settlors, and the taxpayer and his wife had no substantial control over, or interest in, the corpus or income thereof. (R. 152.)

The taxpayer and the trustees of the Thomas H. Brodhead trust and of the Elizabeth S. Brodhead trust really and truly intended to, and did, join together for the purpose of carrying on the business of T. H. Brodhead Company and sharing in its profits and losses. (R. 152.)

STATEMENT OF POINTS TO BE URGED

The points upon which the Commissioner relies as the basis for this proceeding are set forth at pages 167-169 of the record. In substance, they are that the Tax Court clearly erred in holding that the taxpayer did not retain sufficient control over the property which he had purportedly given away to remain taxable on the income attributable to that property and in holding that the donee-trusts were the true owner-contributors of the gift capital upon which their claims of partnership status were based.

SUMMARY OF ARGUMENT

In the case at bar we have an almost identical factual pattern to that in *Commissioner* v. *Sultan,* No. 13,804, now pending in this Court, and to that in *Toor* v. *Westover,* where this Court held that the taxpayer in that case remained the substantial owner of the assigned property. The trustees here were not free to remain out of the partnership; they were not free to terminate the

partnership or transfer their interest as special or limited partner; the donor, as controlling general partner, retained the powers of management and control over the time and amounts of distributions of profits. The Tax Court erred, therefore, in holding that in transferring property in trust for the benefit of his minor children the taxpayer did not retain sufficient control over the property to be treated for tax purposes as the recipient of income therefrom.

To have acquired partnership status for tax purposes an alleged partner must have contributed to the partnership one or both of the ingredients of income—capital or services. Where partnership status is based solely on the contribution of gift capital, the alleged partner must have been the true owner-contributor of that capital. As a special or limited partner the trust in the case at bar could not have contributed services to the conduct of the partnership business. Moreover, it was not the owner-contributor of the gift capital because it was not free to withhold such capital from the partnership, to transfer its interest in the partnership, or to withdraw either the gift capital or the income attributable to it. The Tax Court erred, therefore, in holding that the trust was entitled to recognition as a partner for tax purposes.

ARGUMENT

I

The Tax Court Erred in Holding that in Transferring Property In Trust for the Benefit of His Minor Children the Taxpayer Did Not Retain Sufficient Control Over that Property To Be Treated for Tax Purposes as the Recipient of Income Therefrom

The case at bar presents a factual pattern almost identical to that in *Toor* v. *Westover,* 200 F. 2d 713

(C.A. 9th), certiorari denied, 345 U.S. 975, and likewise almost identical to that in *Commissioner* v. *Sultan,* No. 13,804, presently pending before this Court.[2] In our brief in the *Sultan* case, we have discussed at some length this Court's decision in the *Toor* case and other applicable decisions, and have pointed out why those decisions require a reversal of the Tax Court. For like reasons, a reversal is required in the present case.

As in the *Toor* and *Sultan* cases, this case involves a package arrangement of trusts and a special or limited partnership. In this case, as in *Sultan,* the Tax Court, failing to focus on the end result of the partnership-trust arrangement, has improperly treated each separately and has ignored or viewed as immaterial critical facts found by it. In this manner, we submit, the Tax Court has reached a clearly erroneous conclusion, as it did in *Sultan.*

Like the donee in the *Toor* case, *supra,* the donee in the present case "was neither free to remain out of the partnership nor free to terminate or transfer his interest once the partnership was created." The donee-trust was not free to remain out of the partnership because of paragraph lettered (a) of each of the two trust indentures. Paragraph lettered (a) of the Thomas H. Brodhead trust indenture provided that the trustees should use the entire amount transferred to them by the settlor to purchase a 50 per cent interest in the partnership and that they should continue to be a special or limited partner. (R. 53.) Paragraph lettered (a) of the Elizabeth S. Brodhead trust indenture provided that

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[2] In *Commissioner* v. *Eaton,* No. 13,806, docketed in this Court immediately following the instant case, the same factual pattern is also presented.

the trustees should use the entire amount transferred to them by the settlor to purchase the interest of the Thomas H. Brodhead Trust in the partnership and that they should continue to be a special or limited partner.[3] (R. 93.) The donee-trust was not free to terminate the partnership during its ten-year term [4] because of paragraph numbered 11 of the special partnership agreement. Paragraph numbered 11 provided that the partnership could be determined or terminated by the general partner, namely, the taxpayer alone. (R. 72.) The donee-trust was not free to transfer its interest in the partnership because of paragraph numbered 8 of the special partnership agreement. Paragraph numbered 8 provided that the special or limited partner (the donee-trust) could assign its share or interest in the partnership only with the consent of the general partner (the taxpayer) who had full power and discretion to give or withhold such consent. (R. 71.) Moreover, paragraph numbered 7 of the special partnership agreement provided that only the general partner (the taxpayer) would have authority to transact partnership business and that he would establish the policy of the partnership (R. 70); paragraph numbered 4 provided that only such portion of the profits attributable

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[3] The taxpayer's wife, Elizabeth S. Brodhead, clearly acted merely as a conduit for his transfer of the corpus to the Elizabeth S. Brodhead trust. Having this second trust created to acquire the interest of the first trust was necessary to eliminate those provisions of the first trust believed to render the trust income taxable to the taxpayer-settlor because those provisions appeared in paragraph lettered (c) of the first trust indenture which by virtue of paragraph lettered (o) could not be amended. (R. 54, 62.) Court approval of the trust company's being a co-trustee in the arrangement was not necessary because such approval had been previously obtained under almost identical circumstances. See *Commissioner* v. *Sultan*, No. 13,804, now pending on appeal to this Court.

[4] The term of the partnership in the *Toor* case was 13 years.

to a partner's interest could be withdrawn from the partnership as the partners (including the taxpayer) might deem advisable [5] (R. 69). Thus, the assignor in the case at bar, as in the *Toor* case,[6] remained the substantial owner of the partnership interest which he purportedly had given away.

In *Helvering* v. *Horst,* 311 U.S. 112, the Supreme Court stated (p. 119):

> We have held without deviation that where the donor retains control of the trust property the income is taxable to him although paid to the donee.

In the case at bar the trustees did not acquire the usual attributes of ownership with respect to the trust property. They were required to invest it in the partnership; as a limited partner, they had no voice in the use of their investment; and they were not free either to withdraw or transfer their interest. The taxpayer-settlor, on the other hand, retained complete control over the trust property which he had purportedly given away. He was assured that it would immediately be returned for use in the business which he controlled. The partnership which he dominated could also use it in any other business. Its use by the partnership was to be without restriction by the donee-trust—because the

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[5] Paragraph numbered 4 provided that the amount of distributive net profits would be arrived at after deducting the compensation of the general partner actively engaged in the business in such amount as the partners from time to time agreed upon constituting the reasonable value of the services rendered. (R. 69.)

[6] In the *Toor* case the trustee-bank apparently acted completely in a fiduciary capacity. In the instant case, however, paragraph lettered (l) of the first trust indenture and paragraph lettered (k) of the second trust indenture provided that the trustees would not be answerable or accountable for any loss or damage resulting from any act consented to by the settlor. (R. 61, 100.)

donee-trust was only a special or limited partner. Its continued availability was assured because the donee-trust was not free to withdraw or transfer its interest. Determinations of the taxpayer, as general partner, were binding upon the partnership and he established the policy of the partnership. By his purported transfer of property in trust for the benefit of his minor children, therefore, the taxpayer in reality merely parted with the right to receive income from that property.[7] Of course, as observed in our *Sultan* brief and as stated by the Supreme Court in *Commissioner v. Sunnen,* 333 U. S. 591, 604:

> It has long been established that the mere assignment of the right to receive income is not enough to insulate the assignor from income tax liability.

II

The Tax Court Erred in Failing To Hold That Neither Trust Was Actually the Owner-Contributor of the Capital Necessary To Give It Recognition as a Special or Limited Partner for Tax Purposes

In our brief in the *Sultan* case, we have pointed out that in *Commissioner* v. *Culbertson,* 337 U.S. 733, the

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[7] The taxpayer also even retained the right indefinitely to use that income since by virtue of paragraph numbered 4 of the special partnership agreement the maximum to which the trust was actually entitled was an account receivable. (R. 69.) Use of trust property income already paid to the trustees was also made possible by the provision of paragraphs lettered (g) and (f) of the first and second trust indentures, respectively, that the trustees could make loans to the partnership without liability for any resulting losses. (R. 57, 96-97.) See Section 29.22(a)-21(e)(2) of Treasury Regulations 111, Appendix, *infra*. Further control by the taxpayer-settlor of the trust property income was contained in the provision of these same paragraphs that approval of the taxpayer-settlor was required for all investments of such income by the trustees. (R. 57, 96.) This provision alone would be sufficient to render the trust property income for 1948 taxable to the taxpayer-settlor under Section 29.22 (a)-21(e)(4) of Treasury Regulations 111, Appendix, *infra*.

Supreme Court held that in order to acquire partnership status for tax purposes, it is necessary not only that the alleged partner have contributed either services or capital to the partnership [8] but also that, where such status is claimed on the basis of a contribution of gift capital, the alleged partner have been the true owner of that capital.

In the case at bar the taxpayer and his wife have not contended that either trust, as a special or limited partner, did, or could under the laws of Hawaii, contribute services to the conduct of the partnership business. The partnership status of each trust, therefore, must rest upon the claim that it was the true owner, and therefore the contributor, of the gift capital. Of course, an alleged partner may be the true owner-contributor of gift capital if he voluntarily puts such capital in or voluntarily leaves it in the partnership. Here, however, as previously mentioned, each donee-trust had no option. It was not free to remain out of the partnership nor free to terminate or transfer its interest once the partnership was created. The gift of capital to each trust was conditioned upon the investment of that capital in the partnership. At the will of the general partner, the taxpayer, such capital, and also the income attributable to it, was to remain available for partnership use, a use with respect to which each trust, as a special or limited partner, had no voice. Under the circumstances, neither trust was the true owner of the gift capital. Accord-

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[8] The opinion of the court below has placed unwarranted emphasis on the matter of intent in the instant case as it did in the *Sultan* case; and it may be observed here as there that while the intent of the parties is frequently the ultimate question in determining whether a family partnership arrangement is genuine, of course, parties do not become partners merely by intending to be such.

ingly, neither trust was entitled to recognition as a partner for tax purposes.

CONCLUSION

The decisions of the Tax Court are erroneous and should be reversed.

Respectfully submitted,

H. Brian Holland,
Assistant Attorney General.
Ellis N. Slack,
Lee A. Jackson,
Joseph F. Goetten,
Special Assistants to the Attorney General.

August, 1953.

APPENDIX

Internal Revenue Code:

Sec. 22. Gross Income.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

(26 U.S.C. 1946 ed., Sec. 22.)

Sec. 182. Tax of Partners.

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

* * * * *

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183(b).

(26 U.S.C. 1946 ed., Sec. 182.)

Revised Laws of Hawaii (1935):

Chapter 225. Partnerships, Registration of.

* * * * *

Sec. 6870. *Between individuals.*—A partnership may be formed between two or more individuals for the transaction of any lawful business. A special

partnership may be formed between one or more persons, called general partners, and one or more persons called special partners, for the transaction of any business.

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Sec. 6880. *Only general partners act.*—The general partners only shall have authority to transact the business of a special partnership.

Sec. 6881. *Special partners may advise.*—A special partner may at all times investigate the partnership affairs and advise his partners or their agents as to their management.

Sec. 6882. *May loan money. Insolvency.*—A special partner may lend money to the partnership or advance money for it, or to it, and take from it security therefor, and as to such secured loans or advances has the same rights as any other creditor, but in case of the insolvency of the partnership all other claim which he may have against it must be postponed until all other creditors are satisfied.

Sec. 6883. *Receive interest and profits.*—A special partner may receive such lawful interest and such proportion of profits as may be agreed upon, if not paid out of the capital invested in the partnership by him or some other special partner, and is not bound to refund the same to meet subsequent losses.

Sec. 6884. *May not withdraw capital.*—No special partner, under any pretense, may withdraw any part of the capital invested by him in the partnership during its continuance.

Sec. 6885. *Result of withdrawing capital.*—If a special partner withdraws capital from the firm, contrary to the provisions of sections 6883 or 6884, he thereby becomes a general partner.

Treasury Regulations 111, promulgated under the Internal Revenue Code:

Sec. 29.22(a)-21 [as added by T. D. 5488, 1946-1 Cum. Bull. 19, and as amended by T. D. 5567, 1947-2 Cum. Bull. 9.]. *Trust income taxable to the grantor as substantial owner thereof.*—

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(e) *Administrative control.*—Income of a trust, whatever its duration, is taxable to the grantor where, under the terms of the trust or the circumstances attendant on its operation, administrative control is exercisable primarily for the benefit of the grantor rather than the beneficiaries of the trust. Administrative control is exercisable primarily for the benefit of the grantor where—

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(2) a power exercisable by the grantor, or any person not having a substantial adverse interest in its exercise, or both, whether or not in the capacity of trustee, enables the grantor to borrow the corpus or income, directly or indirectly, without adequate interest in any case, or without adequate security except where a trustee (other than the grantor or spouse living with the grantor) is authorized under a general lending power to make loans without security to the grantor and other persons and corporations upon the same terms and conditions; or

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(4) any one of the following powers of administration over the trust corpus or income is exercisable in a nonfiduciary capacity by the grantor, or any person not having a substantial adverse interest in its exercise, or both: a power to vote or direct

the voting of stock or other securities, a power to control the investment of the trust funds either by directing investments or reinvestments or by vetoing proposed investments or reinvestments, and a power to reacquire the trust corpus by substituting other property of an equivalent value.

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